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La version française du présent rapport est disponible sur demande à l'adresse suivante :

Canadien National, Affaires publiques et Publicité

CN

System Highlights

Five Year Financial and Statistical Summary

($ millions unless otherwise indicated)	1988	1987	1986	1985	1984
Operations					
Revenues	$ 4,676.2	$ 4,786.0	$ 4,874.5	$ 5,017.8	$ 4,987.5
Operating income	$ 543.6	$ 487.4	$ 279.4	$ 440.0	$ 552.9
Interest expense – net	$ 300.5	$ 371.9	$ 382.3	$ 336.2	$ 349.1
Net income (loss)	$ 282.7	$ 120.6	$ (86.3)	$ 117.6	$ 242.0
Dividend	$ 56.5	$ 24.1[1]	–	$ 23.5[1]	$ 48.4
Return on average investment %	10.3	7.9	4.6	7.2	9.2
Return on average equity %	8.7	4.0	–	3.5	7.5
Capital Expenditures					
Property and equipment	$ 386.3	$ 482.1	$ 484.1	$ 744.5	$ 713.1
Assets and Working Capital					
Current assets	$ 945.7	$ 965.8	$ 1,124.6	$ 1,128.0	$ 1,019.9
Working capital deficiency	$ 194.0	$ 485.4	$ 373.6	$ 358.6	$ 266.7
Properties	$ 5,770.4	$ 6,212.5	$ 6,248.5	$ 6,193.5	$ 5,771.0
Total assets	$ 6,906.0	$ 7,593.6	$ 7,842.6	$ 8,138.8	$ 7,466.6
Capital Structure					
Long-term debt (including current portion)	$ 2,014.9	$ 2,936.9	$ 3,358.3	$ 3,172.2	$ 2,692.4
Equity	$ 3,374.9	$ 3,101.1	$ 3,004.6	$ 3,418.5	$ 3,324.3
Debt ratio %	37.4	48.6	52.8	48.1	44.7
Traffic					
Revenue ton miles freight (billions)	104.5	101.7	94.2	91.6	97.4
Employees					
Average number for year	43,933[2]	50,862	56,715	61,124	66,234
Average annual wage per employee	$ 39,042[2]	$ 36,706	$ 35,680	$ 34,484	$ 32,905
Average annual cost per employee	$ 48,940[2]	$ 46,218	$ 43,897	$ 41,016	$ 39,339
Expenditures in Canada					
Purchases	$ 908.7	$ 895.0	$ 1,034.0	$ 1,232.0	$ 1,295.0
Wages, salaries and fringe benefits	$ 1,872.6[2]	$ 1,969.8	$ 2,064.1	$ 2,070.0	$ 2,212.9
Taxes	$ 348.1	$ 351.7	$ 367.3	$ 347.0	$ 343.5

(1) *Reversed in 1988*

(2) *Excluding business units sold during 1988*

CN

The Honourable Benoît Bouchard
Minister of Transport

Brian Gallery
Acting Chairman

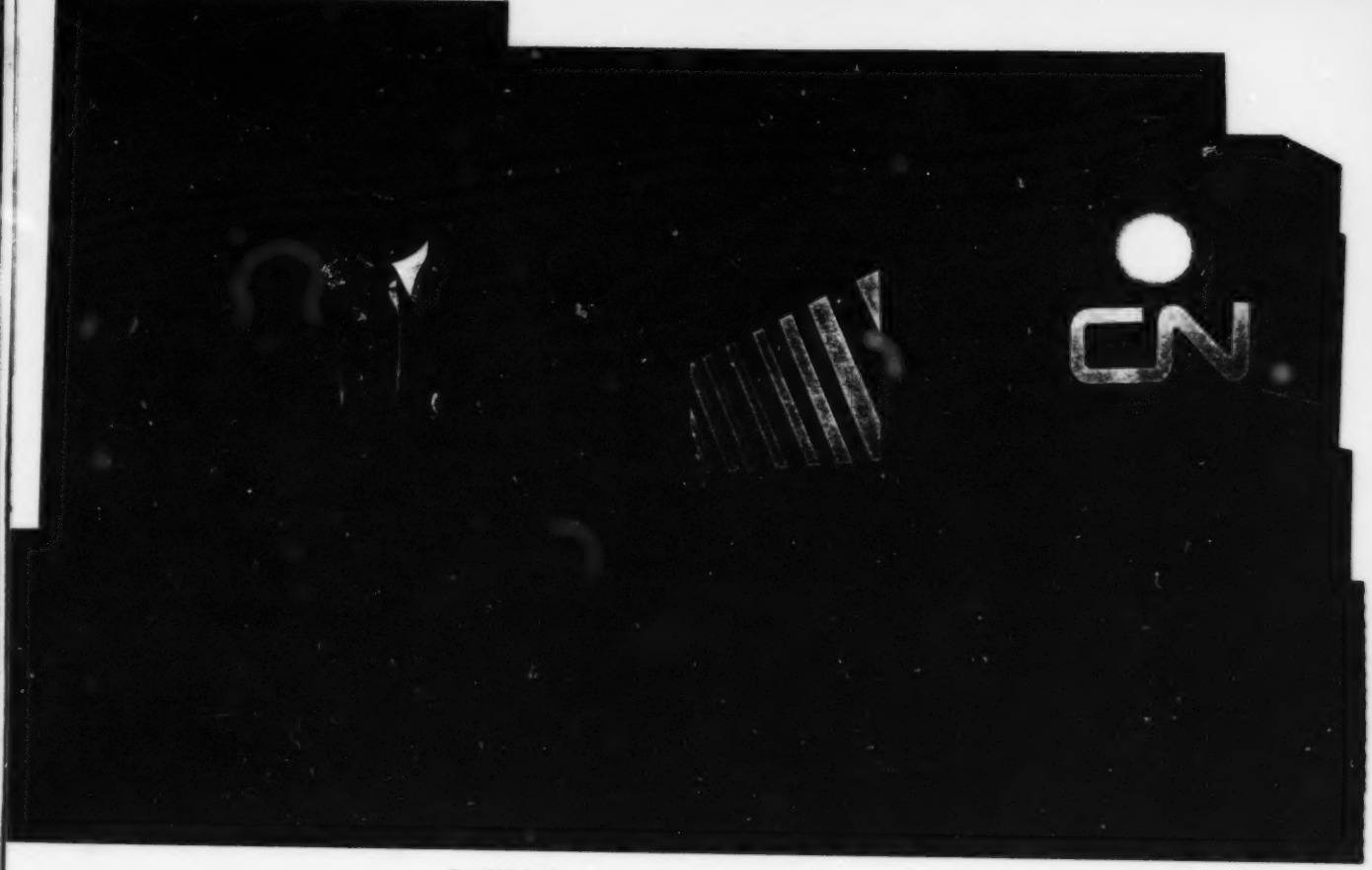
Dear Mr. Minister:

On behalf of the Board of Directors and in accordance with provisions of the Railway Act, I am pleased to submit Canadian National's annual report for the year ending December 31, 1988.

All of the people working on behalf of Canadian National, directors, officers and employees, are extremely proud of the company's many achievements during the past year. Major changes have been made to the structure of the company and imaginative new ideas have been implemented to provide better service to Canadian shippers. The company has also taken a more aggressive attitude in its response to the marketplace and this has played a large part in its financial success during 1988.

The coming years hold great promise for Canadian National. With pride, dedication and many skills, the men and women who comprise CN today are confident and prepared for the future.

Brian Gallery



Ronald E. Lauless
President and Chief Executive Officer

President's Report

As Canadian industry heads towards the last decade of the century, Canadian National has good reason to consider itself among those in the vanguard. Over the past few years, the corporation has emerged from the shadow of crippling indebtedness into renewed financial strength.

During 1988, CN earned net income of $282.7 million, more than twice the previous year's $120.6 million. In part, Canada's buoyant economy was responsible for the impressive result. Equal credit must go to all employees for helping CN win an imposing share of railway business and keeping costs in check.

The corporation continued to reduce long-term debt, mainly through timely divestiture of non-rail assets. Divestiture of hotel and telecommunications holdings resulted in a more streamlined corporate structure and placed CN in a better position to develop and strengthen its core businesses.

But we know we must avoid allowing justifiable pride in the accomplishments to mask awareness of business realities. The signal lights ahead may not be red, but their amber glow tells us that our optimism has to be tinged with some apprehension about pressing issues which face us over the next few years.

It is clear that current income levels will not be sufficient over the long term to guarantee the financial fitness of the corporation. A pre-tax income in the range of $500 to $600 million is needed annually, during the next few years, if CN is to meet capital requirements for renewal of plant and equipment and to continue on the road to financial health.

CN has a mandate to provide efficient rail-based transportation services in a sound commercial manner. The key to performing that mandate successfully is to produce service excellence, which can only be achieved if the company is financially healthy, and if its service offerings and the size of its rail plant conform to the demands of its marketplace.

The future holds many challenges, but also opportunities, for Canadian industry. A highly competitive global economy demands radical altering of business strategies, while the Free Trade Agreement with the United States holds out the promise of unprecedented opportunity.

In transportation, the Government of Canada took a major step forward with the National Transportation Act, 1987. By promoting greater competition among carriers, the Act has benefitted freight shippers, thereby increasing the competitiveness of Canadian goods on international markets.

John H.D. Sturgess

Senior Vice-President and Chief Operating Officer

Yvon H. Masse

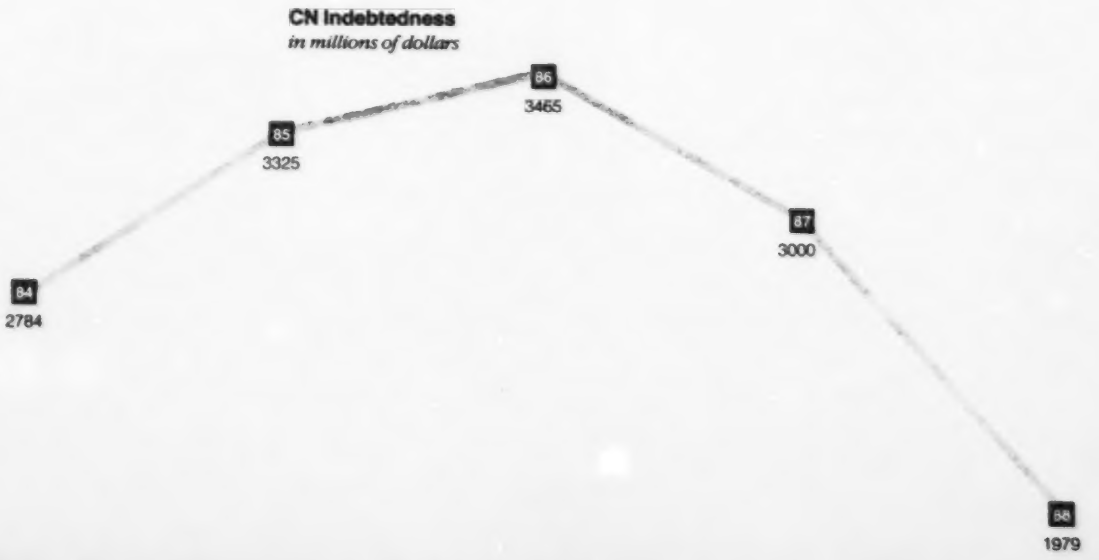
Senior Vice-President and Chief Financial Officer

William H. Morin

Group Vice-President

However, the legislation also holds some risks to the future viability of Canadian railways. Increased competition has restricted their ability to counter cost increases through parallel rate action. While revenue per workload unit has been declining, costs of operation continue to rise in concert with inflation.

The financial health of Canadian railways also depends largely upon achieving regulatory equity with the trucking industry. Over the past 40 years, massive public investment in the highway system has permitted the trucking mode to take the lion's share – close to 70 per cent – of the freight transportation market.



Another wave of pressure appears to be building up for massive public spending on highway expansion. Truck operators, as major users, do not come close to contributing their fair share of costs to maintain and upgrade the public highway system. Railways, having sole responsibility for funding construction and maintenance of their own infrastructure, are clearly at a competitive disadvantage.

Continued erosion of the railways' traffic base, and insufficient returns to improve service and capacity, may limit the competitiveness of the rail mode in Canada and therefore the quality of services we can offer.

Canadian railways are undergoing change on a massive scale as they adjust to a new economic order. We need the understanding of our employees, their unions, business and community leaders, all Canadians and their elected representatives, to implement the changes.

We are conscious of our responsibilities to employees and communities affected by the changes, and to society in general. But we are equally aware that changes are necessary and ultimately for the good of all Canadians.

The theme that guides our efforts is quality service – based on awareness of markets and customer needs, continued productivity improvement, technological leadership, financial strength and stability, and quality performance by all employees. With that objective in mind, we look forward to the future with confidence.

R E Lawless

Ronald E. Lawless

CN service to Newfoundland went totally intermodal in 1988, and Roy Locke, sales and service representative, knows he has a top-quality product to sell.

CN: The Shape of Things to Come

Like Canada, this national transportation corporation reflects the shape of things to come. Its form still recalls CN's past as a rail network which truly spanned the nation. But it is a corporation continually shaped by modern society's needs.

During 1988, preparing for the future involved three important thrusts:

- Shaping the organizational structure for optimal customer awareness and operational efficiency.
- Planning the outlines of the rail network CN will need to meet the distribution needs of freight shippers.
- Improving the financial fitness of the corporation through debt reduction and cost containment.

In marketing, eight commodity-based business units span the entire freight spectrum; each is devoted to developing business for a specific product group.

In operations, a slimmer, more responsive organization began to take shape during the year. The main purpose is to ensure that train and terminal services closely reflect the needs of customers.

The company established a planning unit early in 1988 to design the rail network CN will need for the future. With two-thirds of CN's trackage carrying just 10 per cent of its traffic, some pruning of the network is clearly necessary. The unit is developing a plan for orderly disposition of non-viable rail lines through sale, transfer to other operators, or abandonment.

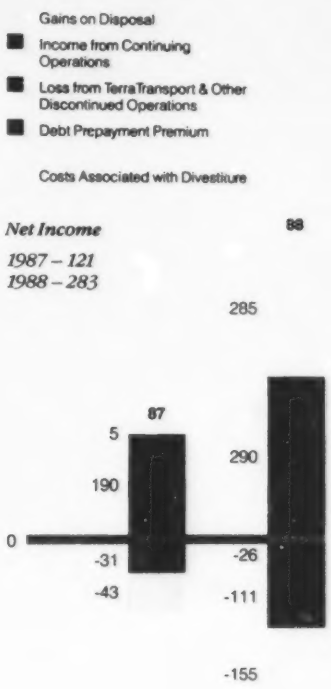
Under terms of the Newfoundland Transportation Initiative, the narrow-gauge Newfoundland railway was abandoned in 1988. CN converted to intermodal sea and highway-based operations to serve Newfoundland markets.

CN reached agreement with Emons Development Corporation of York, Pennsylvania, for the sale of the Grand Trunk Eastern Line (GTE) which runs 262 kilometres from the Canada-U.S. border at Norton, Vermont, to Portland, Maine. The sale is conditional on labor settlements currently being negotiated.

Several years ago, it became clear that the company no longer needed, nor could it afford, three main shops for servicing locomotives and freight equipment. Consequently, a decision was made to close the shops at Moncton, and to convert Pointe St. Charles shops in Montreal to commercial rolling stock repair work.

Top: A brass shop employee works on maintaining equipment at Pointe St. Charles, Montreal.
Lower photos depict containers carrying Newfoundland traffic by ship and highway.

Elements of Income
in millions of dollars

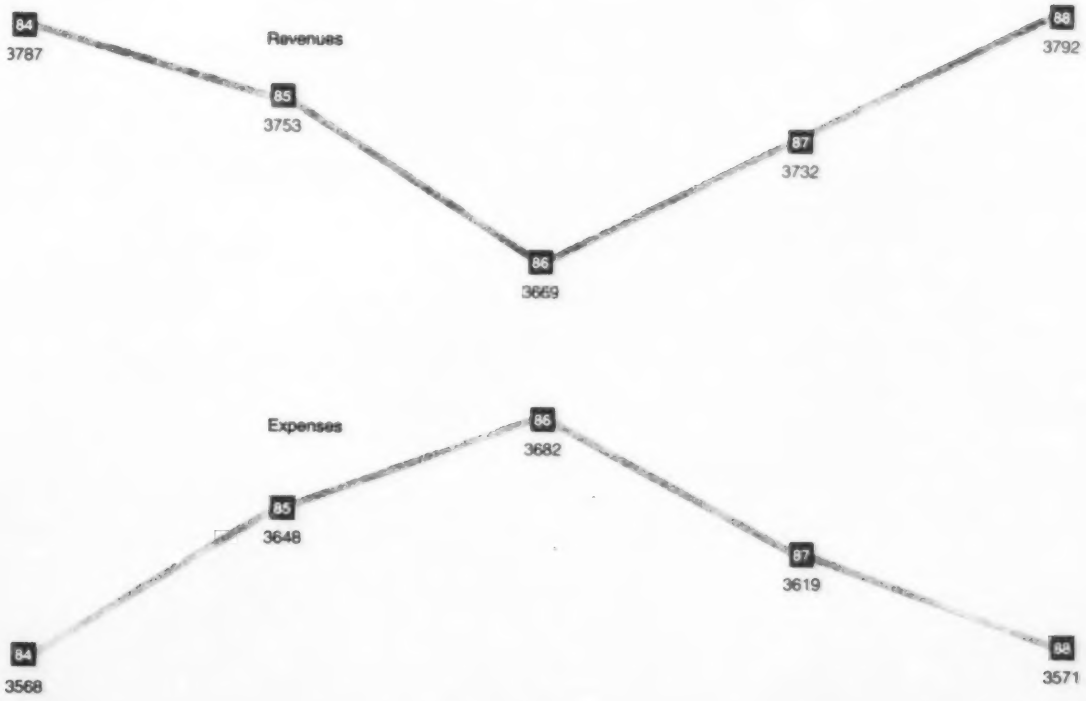


When the Moncton shops closed in September 1988, the majority of its employees received the benefits of early retirement, transfer, or employment security programs. Pointe St. Charles shops won a $90-million contract with VIA Rail Canada to refurbish 157 passenger cars.

Over the year, CN concentrated on bringing down its level of indebtedness. Massive interest payments – in the order of $1 million per day – had been having a debilitating effect on management flexibility.

Considerable progress in this regard was achieved in 1988, mainly through divestitures which were timed to take advantage of optimum market conditions and thus earn the highest possible returns. In each case, CN sought a buyer capable of operating the unit successfully, and insisted on guarantees regarding employee compensation and benefits.

Rail Revenues Compared to Rail Expenses
in millions of dollars



During 1988, CN sold its nine-property hotel chain to Canadian Pacific Hotels Corporation for $265 million. CN's two regional telephone companies were divested, Northwestel to BCE Inc. for $208 million, and Terra Nova Tel to Newfoundland Telephone for $174 million. CN also sold its 50 per cent share in CNCP Telecommunications and in Telecommunications Terminal Systems to CP Limited for $235 million.

The divestitures enhanced the company's financial health and flexibility and will allow CN to concentrate its energies and resources on its core businesses. Proceeds will contribute to a substantial reduction in interest payments.

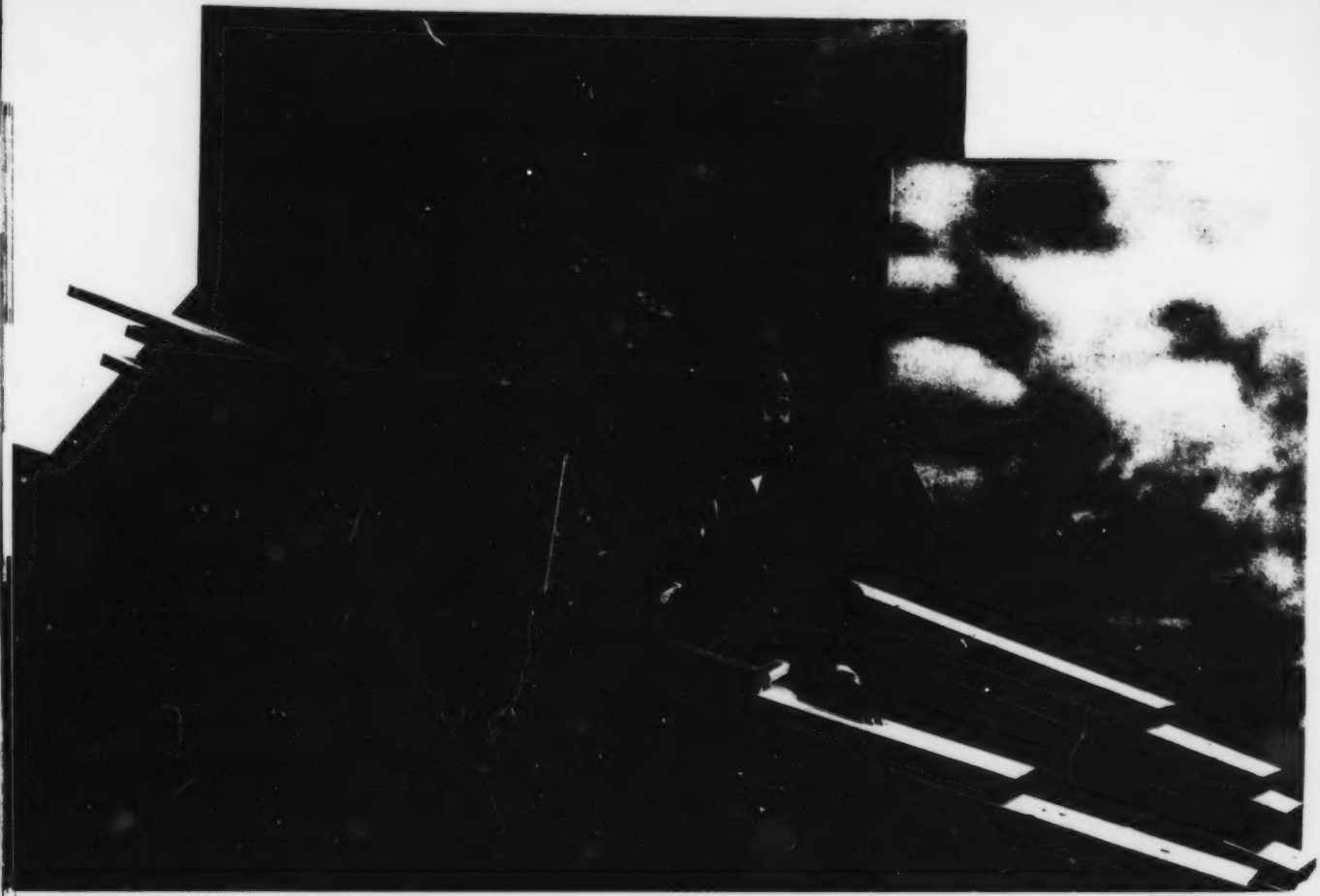
In addition to railway operations in Canada and the United States, core businesses include real estate development, oil and gas exploration, and international consulting. Each of these units performed well in 1988.

To maximize the commercial potential of the company's land holdings, CN Real Estate is involved in a number of projects across Canada. These projects include Toronto's CityPlace, a major redevelopment of downtown railway lands, the Pacific Business Centre in Richmond, B.C., and the Toronto-Dominion Centre Office Tower, a joint venture in downtown Winnipeg.

CN Exploration, responsible for developing the company's petroleum assets in Western Canada, achieved greater production during 1988, although lower prices for crude oil affected income level.

CN's consulting unit, Canac International, attained the highest revenues in its history in 1988. Creation of a U.S. subsidiary will allow Canac to take full advantage of opportunities generated by free trade. Canac Telecom, as partner in a joint venture, was awarded a contract for software and communications systems for the Department of External Affairs.

Halifax is a major port of call for ocean-going container ships. CN's efficient intermodal service links Canadian ports with the heart of the continent.



Joe Letwin, service design manager, operations, part of the team that created new customer-pleasing service patterns for shipping western Canadian lumber to eastern markets.

Opening Doors to Customers

CN is dedicated to the concept of meeting the transportation needs of its customers in the most efficient way achievable at competitive prices.

Today the philosophy is "Find out what the customer wants and, if it makes good business sense, help in reaching that goal." With sound planning, both the carrier and the shipper will win.

This concept assumes tremendous importance with the emergence of powerful trading blocs and growing global competition for access to markets.

The National Transportation Act, 1987, has helped set the groundwork for developing and applying the concept in Canadian transportation.

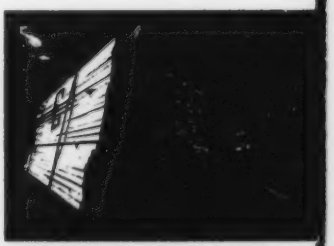
In anticipation of the more competitive marketplace, CN strengthened its marketing organization in 1988 by building on eight commodity-based business units. These specialized units work in partnership with CN's regional organizations, customers and potential customers to develop service arrangements suited to marketplace needs.

CN capitalized on its ability to negotiate confidential contracts with customers, permitted for the first time under NTA '87. By year-end, CN had filed some 375 contracts with the National Transportation Agency, and had an additional 450 nearing conclusion. These contracts represent more than 50 per cent of the railway's revenue, excluding western grain. They give the railway added incentive to provide services tailor-made to customers' specific needs.

Freight volumes rose by four per cent to 128 million tons, although a softening in grain shipments began to occur late in the year as a result of drought conditions in Western Canada. Revenues rose by 2.3 per cent to $3.5 billion, but revenue per ton mile dropped by about 1.4 per cent, reflecting, in part, the pressure of deregulation on rates.

CN devoted particular attention during 1988 to the highly competitive intermodal market. A new weekly container train from Vancouver to markets in Toronto and Montreal was introduced, cutting transit time and handling costs for shippers.

The company announced plans for construction of a new $19-million intermodal terminal near Vancouver, adding to the existing network of major terminals at Moncton, Montreal, Toronto, Winnipeg, and Edmonton.



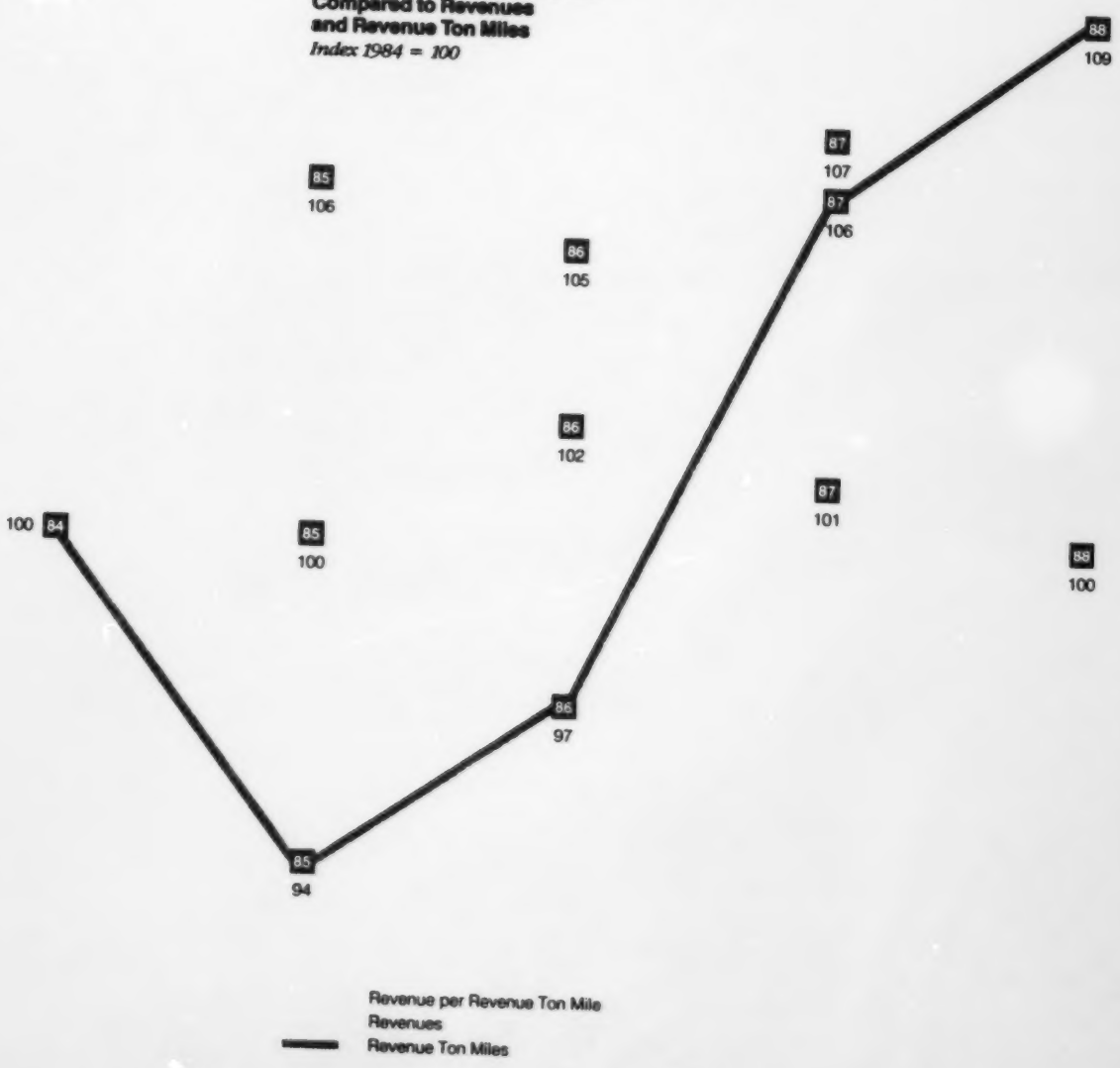
Lumber and newsprint are important Canadian export products requiring careful handling and tight scheduling, all the way from Canada's forests to consumers throughout North America.

A $20-million upgrading of intermodal facilities in Montreal was completed, while the Toronto terminal at Brampton is being expanded.

As CN sheds underutilized trackage to become a more streamlined rail network, intermodal services are providing a continuing link with freight shippers through rail-highway-marine connections.

Termination of railway service in Newfoundland during 1988 allowed CN to expand intermodal services to the province, giving shippers a superior sea and highway-based transportation product.

Revenue per Revenue Ton Mile Compared to Revenues and Revenue Ton Miles
Index 1984 = 100

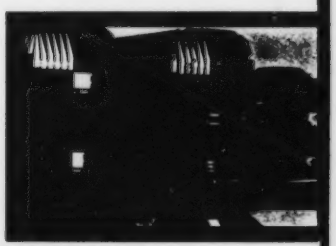


As CN faces an increasingly competitive environment, it is clear that a focus on customer service – on top-quality performance – is essential on the part of each of its employees.

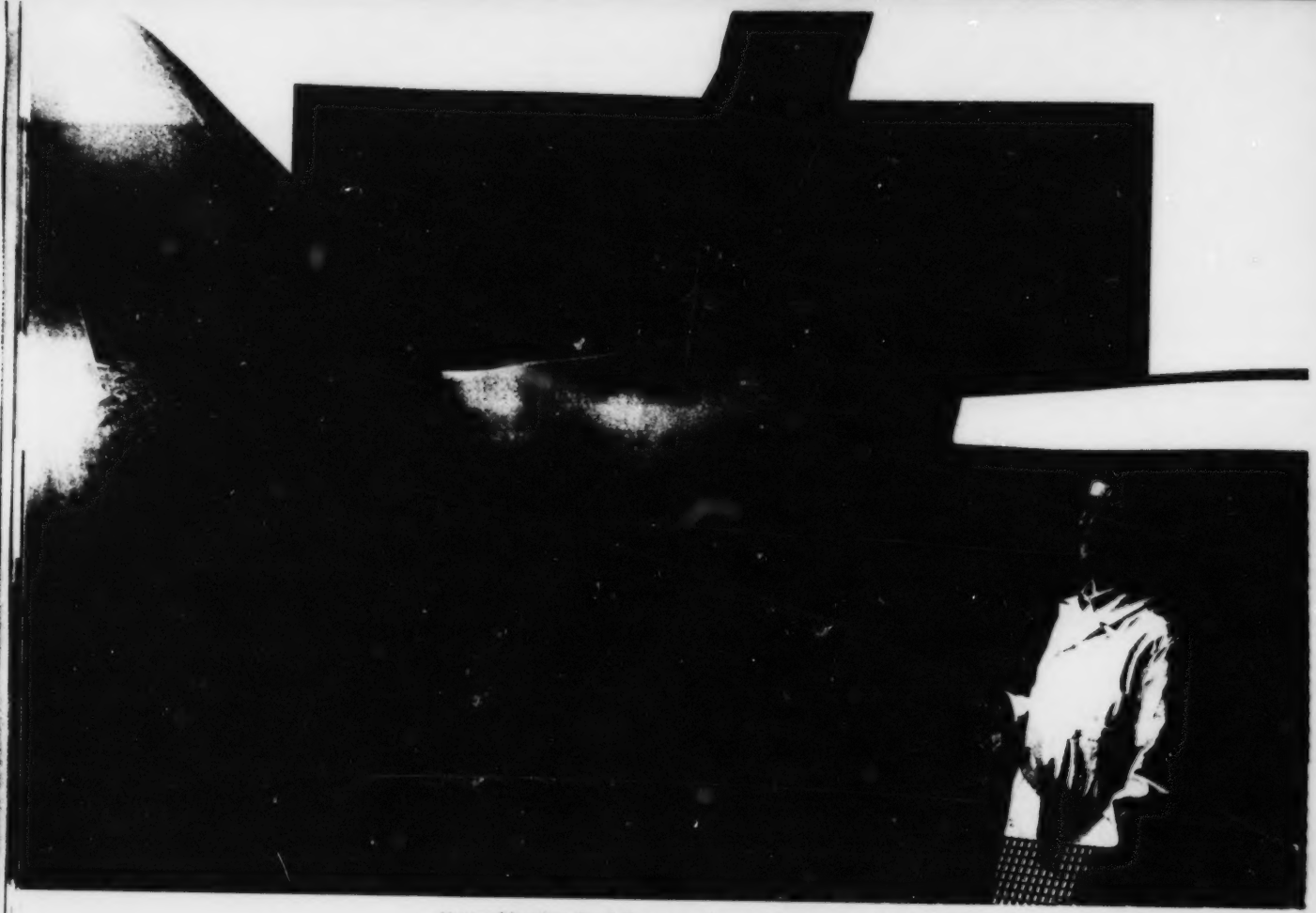
This is the philosophy behind recent innovations in CN's five regional customer service centres. The centres draw together a variety of customer services; the staff handles requests for service and information, using advanced computer and communications technology to provide up-to-the-minute response. They are keenly aware that CN's reputation for reliable service depends on how well they respond.

The three units of the Grand Trunk Corporation, CN's subsidiary in the United States, performed well in 1988. Higher traffic levels led to greater income from operations for the Grand Trunk Western, Central Vermont, and Duluth, Winnipeg and Pacific railways.

The Grand Trunk Western paved the way towards greater productivity and competitiveness by negotiating a new labor agreement which permits reduction in the size of train crews. Some of the savings realized will be passed on to employees, while a flexible separation program will assist those directly affected.



CN's sales and service centre in Chicago, top photo, coordinates the efforts of nine sales offices in the United States.
Bottom: Trainloads of Canadian-built automobiles and parts are assembled at Toronto for shipment to U.S. markets.



Master of the robots, Ken Balla, oversees the new electronic wizards that paint covered hoppers for potash and grain service safely and efficiently at Winnipeg's Transcona shops.

Quality Technology for Productivity and Safety

Quality has seldom counted more than it does today in the rapid evolution of the transportation industry. The technological revolution is well under way and accelerating.

CN

Advances in technology enable major steps in improving productivity and safety. Finding more effective, safe and productive ways of managing the operations side of its business is CN's guiding principle in searching out and adopting new technology.

In July, Parliament passed the Railway Safety Act which brings regulation of railway operations in line with 20th-century technology. CN supports the objectives of the new law.

CN completed a program to equip all its high-horsepower main-line locomotives with reset control devices that automatically apply train brakes should the crew be unable to maintain control. Event recorders are being installed in main-line locomotives to help pinpoint the causes of accidents and detect mechanical and electrical problems.

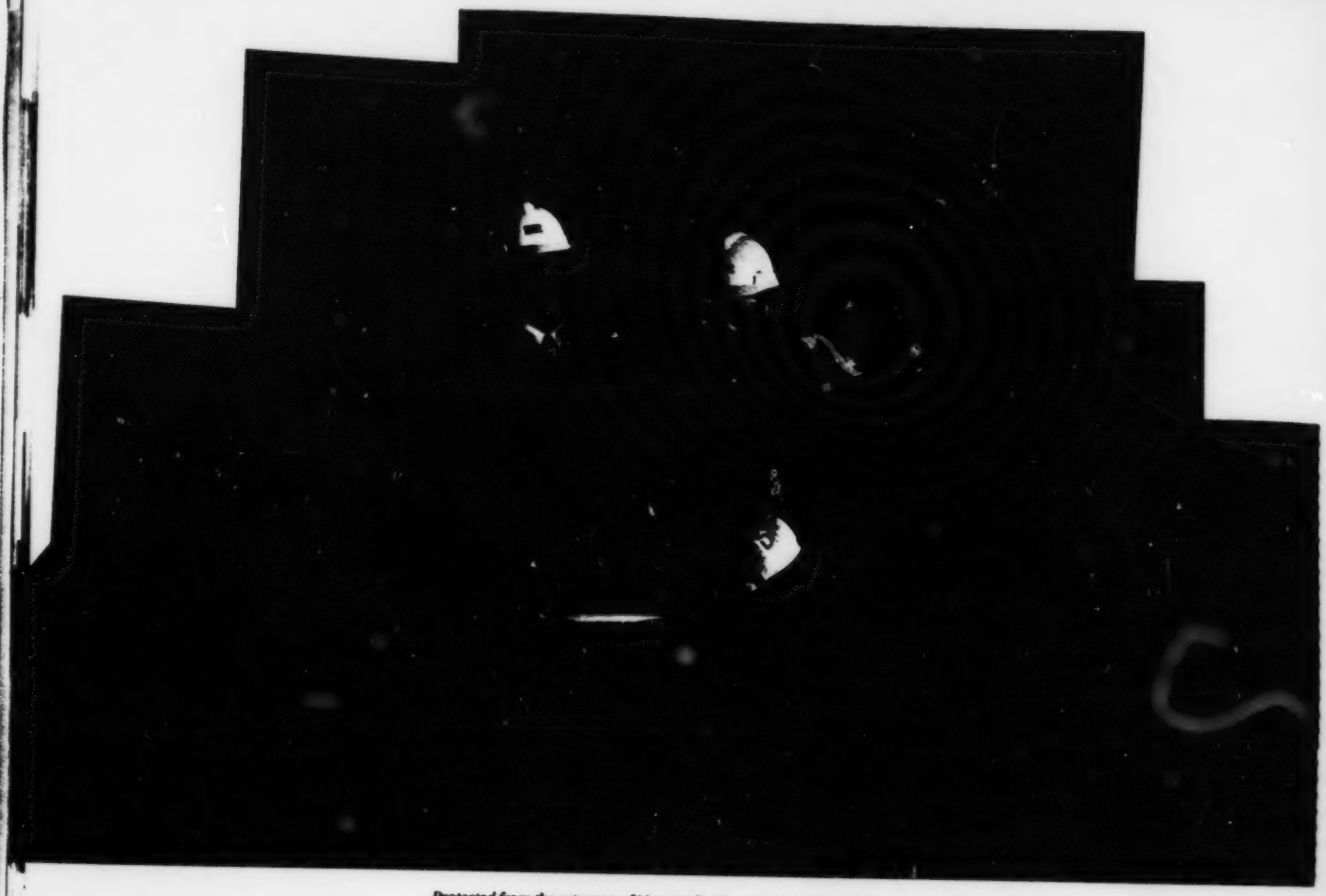
The railway also upgraded its trackside train surveillance systems with the addition of "talking" detectors that alert train crews and dispatching offices to abnormalities in passing trains.

Productivity and safety were the objectives when CN designed and opened a robotic paint shop for hopper cars at its Transcona shops in Winnipeg. North America's first fully robotized facility of its kind, the paint shop has speeded up the task of painting and protecting rolling stock and provides a safer work environment for employees.

In anticipation of heavy traffic demands, particularly in Western Canada, CN ordered 90 new high-power locomotives, 60 from General Motors of Canada Limited and 30 from General Electric Company. The locomotives incorporate the latest developments in safety and crew comfort features.

North American railways, CN among them, are engaged in a cooperative project, called Advanced Train Control Systems (ATCS), to apply modern technology to the business of running trains, safely and with maximum efficiency. CN is working on an ATCS pilot project, to be implemented on its line in northern British Columbia over a period of two years, beginning early in 1989.

Top: Massive cylindrical hopper in grain service.
Centre: A new high-tech, high-comfort locomotive undergoes thorough testing at London, Ontario.
Bottom: New computer technology aids operations control officers in plotting safe and efficient train movements.



Protected from the extremes of Montreal's climate by a new tent-like structure, supervisor Claude St-Laurent (left) and heavy duty mechanic Alain Vézina work on servicing massive cranes and front-end loaders at CN's Monterm intermodal terminal.

People and Progress: Quality Performance

In its long and often dramatic history, CN has been able to boast of a goodwill relationship with the internal strengths that made it tick – the symbiotic force of employees, union representatives, supervisors and managers.

CN

There is no doubt that CN today is largely a product of the people who have worked for it and believed in its future. Their adaptability to change, and their willingness to take on new challenges, have been CN's greatest strength.

People create quality through their ingenuity, dedication and determination. At a time when quality performance matters more than ever before, CN is resolved to foster the spirit that leads to progress at all levels and in all activities.

One step taken in 1988 was the launching of a "quality at work" process. It aims to tap the inherent resources of all employees by encouraging their active participation in developing customer-sensitive service delivery.

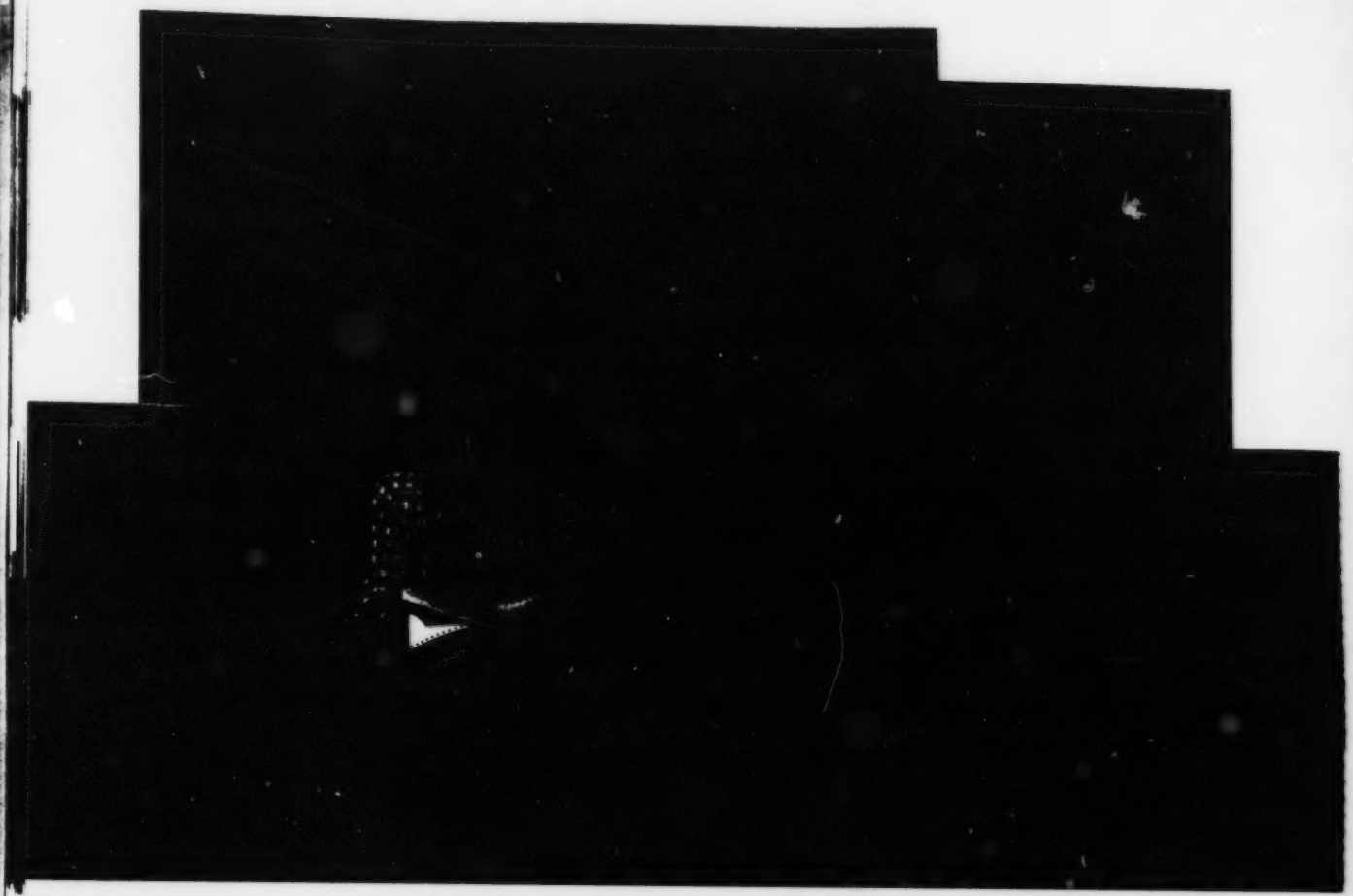
Quality performance also depends on training and equipping employees for their responsibilities. CN intends to ensure that the training programs it offers are appropriate and effective, and has established a task force to review methods, content, costs and results.

Prolonged negotiations with union representatives over a new collective agreement for 1987-88 concluded in 1988 with a series of arbitration awards which established certain conditions and compensation regarding cabooseless trains. The railway companies, believing the arbitrator exceeded his mandate in making such an award, asked the Federal Court of Appeal to set it aside.

During negotiations for a new labor contract, which began in October, CN has attempted to establish a measure of common ground between itself and labor unions on issues that affect competitiveness. The company understands employees' concerns, but it is clear that a viable, competitive CN is in a much better position to offer stable employment.

Negotiations with non-operating unions concluded successfully early in 1989 with a memorandum of settlement on a three-year contract which includes a long-term commitment for indexation of pensions, beginning January 1, 1991, to replace the ad hoc adjustments CN has granted to pensioners since 1971. Negotiations with four other union groups are continuing.

Top: Exterior view of the tent-like structure which shields maintenance employees at Montreal's intermodal terminal.
Centre: High technology comes to bridge inspection.
Bottom: Machinist at work in the Taschereau diesel shop, Montreal.



Serving the grain and oilseeds industry calls for attention to detail and timely information to customers. Trina Duffy, grain market analyst in Winnipeg, generates the kind of information customers rely on.

Progress with a Conscience

Rapid technological change and intense competition on a global scale bring in their wake imposing social challenges. Corporations are hard-pressed to bridge the gap between ethical use of human resources and progress available through technological innovation.

CN

CN aims at progress with a conscience. The company is keenly aware of its responsibility to the people and communities affected by changes it must implement. CN also recognizes its duty to remain attuned to the evolution of social values in its handling of employment issues.

To remain competitive and a viable supplier of vital services to Canadian shippers, CN has to reduce its cost base. This has meant a reduction in the number of people it employs at all levels of the company and in its presence in many communities across Canada. The process has been gradual over the past few years, relying mainly on attrition and early retirement to bring down the employee count.

In 1988, CN employed 43,933 people, not including those employed in activities divested to new ownership. This number represents a reduction of some 4,000 positions, or about eight per cent, from the previous year.

In each case, CN attempted to keep individual hardship to a minimum by giving those affected a range of options and assistance programs, including retraining and transfer opportunities. But the need for productivity improvement and cost containment remains imperative, and downsizing will have to continue in the foreseeable future.

CN supports employment equity principles and is keenly aware that the philosophy not only is right, but also makes good business sense. The company is committed to the hiring, development and promotion of members of the four target groups still under-represented in its workforce – women, native peoples, visible minorities, and people with disabilities. Some progress was achieved with each of these groups during 1988, but there is still a long way to go.

In 1988, the company inaugurated a post-secondary scholarship program for native people involving five awards annually, each worth $2,000. The program complements a similar plan for women interested in non-traditional occupations, launched in 1985.

Grain accounted for almost one fifth of CN's freight volume in 1988. In lower photo, a ship docked at Prince Rupert takes on Canadian grain bound for the Orient.

"CN people consistently demonstrate their commitment to quality customer service," says Doug Cattran, general manager, Western Canada, for Dow Chemical. "Every day, CN's safe, reliable, and cost-effective service is critical to our ability to expand our business opportunities."

Seeing the Eighties Out — CN Looks Ahead

One of the most significant lessons modern society has learned is that smaller can be better, and big can be too big.

CN

In the past, railway developers and politicians were transfixed by visions of bigness in railways – by geographic nation-knitting. But new competitive forces have compelled CN, indeed the entire North American transportation industry, to reassess the economic realities of this closing century.

It became clear that hardening of financial arteries would surely result unless early corrective steps were taken to rationalize physical plant and workforce.

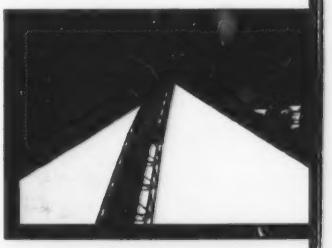
While reaching for excellence in customer service within the restraints of time and cost, CN has taken giant strides towards the future by renewed emphasis on core businesses; by significantly reducing indebtedness; and by consolidating operations through reduced management and workforce.

The shrinking pains have been severe but considerably lessened by humanitarian approaches towards those directly affected.

As to the future, CN is focusing on six primary objectives:

- Quality service based on knowledge of and prompt response to customer needs.
- Greater involvement of employees in the development of customer-oriented services.
- Improved productivity through better deployment of staff and facilities, and implementation of new technology.
- Debt reduction through intelligent financial management.
- Resolution of issues involving CN's competitive position vis-a-vis other modes of transportation.
- Effective management of its core businesses, rail-based transportation and related non-rail assets.

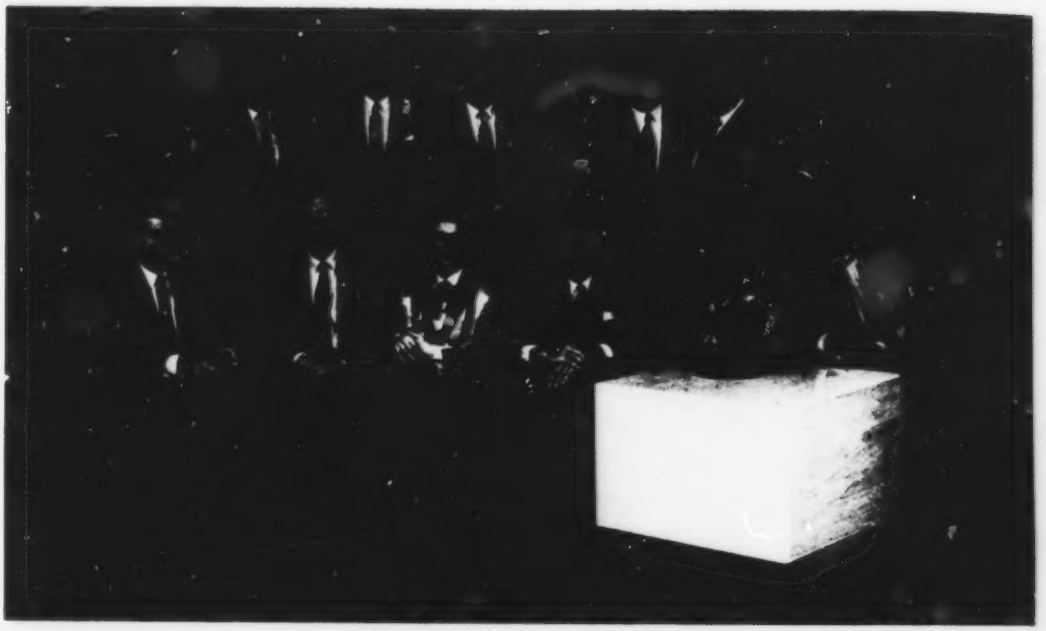
The company is confident that continuing emphasis on quality service performed by a highly efficient workforce and management team will lead it into the best nation-serving role yet achieved in CN history.



Top: Special tank cars loaded with Dow Chemical products at Fort Saskatchewan, Alberta.
Centre: Sulphur, a major bulk commodity for CN, heads from Saskatchewan to Vancouver.
Bottom: A unit train carrying coal for export winds through the mountains.

Directors

as at December 31, 1988



Standing: G. Coulombe, A.J. Bentley, G.T.H. Cooper, J. Johnson, E.A. Mascoll, Y. Poitras
Sitting: R.E. Lawless, E. Demkiw, C.J. Stagg, B.O'N. Gallery, J. Brouwer

B. O'N. Gallery
Acting Chairman
Westmount, Quebec
(2)(3)

A.J. Bentley
Saskatoon, Saskatchewan
(1)(5)

J. Brouwer
West Vancouver,
British Columbia
(2)

G.T.H. Cooper
Halifax, Nova Scotia
(1)
Appointed January 5, 1988

G. Coulombe
Montreal, Quebec
(1)(3)(5)
Appointed June 7, 1988

E. Demkiw
Vegreville, Alberta
(2)(3)

J. Johnson
Winnipeg, Manitoba
(2)(3)(4)

R.E. Lawless
President and
Chief Executive Officer
Beaconsfield, Quebec
(2)(3)

E.A. Mascoll
Toronto, Ontario
(2)(4)(5)

Y. Poitras
St. Quentin, New Brunswick
(1)(4)(5)
Appointed May 26, 1988

C.J. Stagg
Stephenville, Newfoundland
(1)

(1) Member of the Audit Committee

(2) Member of the Compensation Committee

(3) Member of the Investment Committee

(4) Member of the Social Responsibility Committee

(5) Member of the Real Estate Committee

M. Marchand	*end of term June 7, 1988*
G.T. Urquhart	*end of term May 26, 1988*

Officers

as at December 31, 1988

R.E. Lawless
President and
Chief Executive Officer

M.A. Blackwell
Vice-President
Atlantic Region

R. Boudreau, Q.C.
Vice-President – Law

F.D. Campbell
Vice-President
Prairie Region

T. Cedraschi
President and
Chief Executive Officer
CN Investment Division

G.C. Church
Treasurer

P.A. Clarke
Senior Vice-President
Marketing

A.E. Deegan
Vice-President
Great Lakes Region

M.L. De Pellegrin
President and
Chief Executive Officer
Canac International Inc.

B.E. Ducey
Vice-President
Public Affairs and Advertising

J.H. Easton
President and General Manager
TerraTransport

P.J. Foliot
Vice-President
Purchases and Materials

A.J. Gillies
Vice-President
Intermodal

J. Horrocks
Vice-President
Special Projects

B.E. Horsman
Vice-President
Planning and Coordination

C.J. Hudson
President
CNM Inc.

J.P. Kelsall
Senior Vice-President
Operations

J.R. Lagacé
Vice-President
St. Lawrence Region

J.P. Laroche
Vice-President
Employee Relations

G.L. Maas
President
Grand Trunk Corporation

I.G. MacDonald
Vice-President
Financial Planning

D.P. MacKinnon
Vice-President
Strategic Direction

G. Maroulis
Vice-President
Internal Audit

Y.H. Masse
Senior Vice-President
and Chief Financial Officer

R.D. McGrath
Vice-President
Accounting and Comptroller

W.H. Morin
Group Vice-President

A.R. Pozniak
Vice-President
Information Systems

H.J.G. Pye, Q.C.
Vice-President and
Secretary of the Company

G.R. Snowdon
Acting President
CN Communications

J.H.D. Sturgess
Senior Vice-President
and Chief Operating Officer

H.D. Tipple
President
CN Real Estate

D.E. Todd
Vice-President
Government Affairs

W.H. Waddell
President
CN Exploration Inc.

R.A. Walker
Senior Vice-President
Western Canada

Companies

Companies included in the Consolidated Financial Statements of the Canadian National Railway System as at December 31, 1988

Consolidated Companies

Autoport Limited

Canac International Inc.

*Canac International Ltd.

The Canada and Gulf Terminal Railway Company

Canadian National Express Company

Canadian National Railway Company

The Canadian National Railways Securities Trust

Canadian National Steamship Company, Limited

Canadian National Telegraph Company

Canadian National Transfer Company Limited

Canadian National Transportation, Limited

The Canadian Northern Quebec Railway Company

Canat Limited

Canaven Limited

Central Vermont Railway, Inc.

Chapman Transport Limited

CN Exploration Inc.

C.N. (France) S.A.

CNM Inc.

CN Tower Limited

CN Transactions Inc.

Domestic Four Leasing Corporation

Domestic Three Leasing Corporation

Duluth, Winnipeg and Pacific Railway Company

E I D Electronic Identification Systems Ltd.

Empire Freighways Limited

Grand Trunk Corporation

Grand Trunk Land Development Corporation

Grand Trunk Radio Communications, Inc.

Grand Trunk Western Railroad Company

The Great North Western Telegraph Company of Canada

The Minnesota and Manitoba Railroad Company

The Minnesota and Ontario Bridge Company

Mount Royal Tunnel and Terminal Company, Limited

The Northern Consolidated Holding Company Limited

The Quebec and Lake St. John Railway Company

Royal Transportation Limited

**Established in 1988*

Jointly-operated and other companies in which the System has investments

The Belt Railway Company of Chicago

The Canada Southern Railway Company

Canaprev Inc.

Chicago and Western Indiana Railroad Company

Compagnie de gestion de Matane Inc.

Computer Sciences Canada, Ltd.

Detroit River Tunnel Company

Dome Consortium Investments Inc.

Domestic Two Leasing Corporation

Eurocanadian Shipholdings Limited

Fort Point Holdings Ltd.

Halifax Industries (Holdings) Limited

Halierm Limited

Lakespan Marine Inc.

Portage & Main Development Ltd.

The Public Markets, Limited

Railroad Association Insurance, Ltd.

Seabase Limited

Shawinigan Terminal Railway Company

Société du port ferroviaire de Baie Comeau-Hauterive

Telesat Canada

The Toronto Terminals Railway Company

Trailer Train Company

In addition, the property of the Canadian Government Railways is entrusted to the Canadian National Railway Company as part of the System.

RESULTS OF OPERATIONS

System net income for 1988 totalled $282.7 million compared with $120.6 million in 1987 and a net loss of $86.3 million in 1986. Income from continuing operations improved by $103.0 million in 1988 and $185.0 million in 1987. The 1988 improvement was generated principally by CN Rail which experienced record traffic volumes coupled with expense reductions. Results also improved in CN Real Estate and Other Enterprises, while income from Grand Trunk Corporation and CN Exploration were below the 1987 levels. Included in the 1988 improvement in net income were gains of $285.1 million on the disposal of business units, partly offset by closure costs of $92.3 million on discontinued operations and a write-down of assets of $62.7 million, all of which were accounted for as extraordinary items. See Note 2 of Notes to Consolidated Financial Statements. Also affecting income in 1988 was a $111.1 million premium on the early extinguishment of long-term debt.

The largest portion of the 1987 increase in income from continuing operations came from CN Rail where higher traffic volumes, led by record export grain movements, and lower expenses were recorded. Improved results also occurred in Grand Trunk Corporation, CN Real Estate and CN Exploration, while results for Other Enterprises were down. A further improvement occurred due to a reduction of losses from discontinued operations of $10.9 million compared to 1986 and extraordinary items (see Note 2 of Notes to Consolidated Financial Statements) which, before income taxes, decreased by $12.0 million.

The results for each division, which are discussed below, include the assignment of interest expense. This expense aggregated $300.5 million for the System in 1988, $371.9 million in 1987 and $382.3 million in 1986. In both years the decreases were due mainly to reduced debt and the strengthening of the Canadian dollar against the U.S. dollar. See Note 10 of Notes to Consolidated Financial Statements.

CN RAIL

CN Rail's income amounted to $220.7 million in 1988 compared with $113.7 million in 1987 and a loss of $12.2 million in 1986. Increased freight revenues and lower expenses were the main factors in both the 1988 and 1987 improvements.

Railway operating revenues totalled $3,792.1 million in 1988, up $59.8 million from 1987 and $122.7 million from 1986. Freight revenues were $78.4 million higher than in 1987, mainly because of record 1988 traffic levels. The most significant increases occurred in the coal, sulphur, potash; pulp and paper; automotive; and petroleum and chemicals commodity groups. Partially offsetting this improvement were declines in revenues from lumber and wood products; grain; and consumer goods. Other revenues were down from the 1987 levels. Revenues from the contract with Via Rail Canada Inc. (VIA) declined by $53.9 million because of the transfer of responsibility for certain activities to VIA and lower workloads. However, increases in receipts from U.S. currency exchange on interline freight and from other revenues helped to moderate the effect of the VIA reductions.

Freight revenues in 1987 were $130.7 million higher than in 1986 mainly because of increased traffic volumes, particularly in the grain, forest products and intermodal groups. Partially offsetting these increases were declines in revenues from coal, sulphur, potash and automotive traffic, and the revenue reduction occasioned by the volume-related limitation on amounts collectible under the Western Grain Transportation Act for the crop year ended July 31, 1987. Lower receipts from VIA were also a moderating factor in the 1987 revenue level.

Expenses in 1988 were $3,571.4 million, down $47.1 million from 1987 and $110.1 million from 1986. The principal factors in the 1988 reduction were lower interest costs and reduced operations expenses which were achieved despite higher traffic volumes and workloads. Most of the improvement was due to lower equipment maintenance expenses, reduced VIA contract workloads, productivity and other miscellaneous savings resulting from staff reductions. Non-operating expenses were down mainly because of lower pension and equipment lease costs. Expenses in 1987 were below the 1986 level mainly because of lower operations costs due to reduced maintenance expenses, fuel costs, workloads under the VIA contract, productivity improvements and staff reductions.

GRAND TRUNK CORPORATION

Grand Trunk Corporation had income of $12.9 million in 1988 compared with $21.8 million in 1987 and a loss of $14.2 million in 1986. The main factor in the 1988 decline was the 1987 inclusion of non-recurring other income from the sale of two branch lines, investments and other assets in the year's results. Income from operations was over $10 million higher in 1988 than in 1987, with all three operating companies achieving profitability. Lower 1987 employment levels and several major non-recurring expense items in 1986 were the main factors in the 1987 improvement.

Revenues amounted to $477.8 million in 1988, $486.0 million in 1987 and $531.4 million in 1986. The 1988 decline was due to the effect of the strengthening Canadian dollar on the conversion of U.S. dollar amounts. In fact, revenues in U.S. dollars were up by almost 6 per cent and traffic volume rose by about 4.5 per cent with most of the improvement occurring in the automotive, forest products and intermodal groups. Freight rates were up and traffic mix also improved. The 1987 decline was mainly due to a fall in traffic volume, lower unit revenues, shorter hauls and unfavourable changes in commodity mix.

Expenses totalled $464.9 million in 1988, $464.2 million in 1987 and $545.6 million in 1986. Despite approximately $12 million in employee separation costs, reduced other income and increased traffic volumes, wage rates and fuel prices, 1988 expenses remained at about the same level as last year. This was due mainly to the strengthening Canadian dollar, savings from employee reductions and lower interest costs. The main factors accounting for the 1987 expense improvement were reductions in employment levels, divisional consolidations, yard closings, lower traffic volumes, productivity gains and 1986 non-recurring expense items.

ENTERPRISES GROUP

CN Exploration

CN Exploration had income of $3.1 million in 1988, $10.6 million in 1987 and $4.5 million in 1986. The decrease in 1988 was due to declining crude oil prices offset to some extent by increases in production. Increased crude oil prices as well as decreased operating and interest expenses contributed to the 1987 increase.

CN Real Estate

Income from CN Real Estate amounted to $46.8 million in 1988, up $9.0 million from 1987 and $28.0 million from 1986. The increases in both years were due mainly to higher income from property disposals.

Other

Other Enterprises had income of $10.5 million in 1988, $7.0 million in 1987 and $9.0 million in 1986. In 1988, increased income from Canac International Inc. and CN Tower accounted for the improvement. The 1987 decrease was caused largely by reduced income from Canac International Inc.

CN

DISCONTINUED OPERATIONS

Losses on discontinued operations totalled $26.1 million in 1988, $31.1 million in 1987 and $42.1 million in 1986. The 1988 amount includes a nine-month loss of $29.3 million for TerraTransport, a three-month loss of $9.1 million for CN Hotels and a profit of $12.3 million for CN Communications consisting of a nine-month loss for CNCP Telecommunications and eleven months income from the subsidiary telephone companies. The corresponding amounts for the full year of 1987 are losses of $41.3 million for TerraTransport and $13.1 million for CN Hotels, and income of $21.9 million for CN Communications. The 1986 results include losses of $40.3 million for TerraTransport, $6.3 million for CN Hotels and $4.5 million for the Dockyard, a profit of $34.7 million from CN Communications and a $25.6 million loss on ten months of operations for CN Route.

INCOME TAXES

Total income taxes for 1988 have been reduced by the amount of $141.1 million through utilization of tax benefits pertaining to prior years' losses, which reduction was accounted for as an extraordinary item. The corresponding amount for 1987 was $56.4 million. There were no income taxes payable in 1986 because of the System loss. See Note 11 of Notes to Consolidated Financial Statements which indicates that such benefits are available to reduce taxable income of future years.

LIQUIDITY AND CAPITAL RESOURCES

During 1988, proceeds of $882.3 million from the sale of business units, improved net income and other internally-generated funds were sufficient to cover net capital spending requirements and the retirements of a significant amount of long term debt, as well as improve the net cash position.

At the end of 1988, the Company had cash and short term deposits of $36.2 million, an increase of $99.4 million in net cash position from the prior year's level. Moreover, the Company has arrangements with a number of Canadian and U.S. banks which provide lines of credit in excess of the Company's anticipated short-term borrowing requirements. The Company's newly-incurred long-term debt of $5.8 million was in the form of capital leases and conditional sales agreements.

The Company reduced existing long-term debt by $798.3 million. This included the redemption on their call date of 14⅝ per cent U.S. Euro notes in the amount of $117.8 million. In addition, $592.1 million of high-interest bearing U.S. dollar denominated debentures were extinguished before maturity through a combination of open-market debt repurchases and in-substance defeasance. See Note 5 of Notes to Consolidated Financial Statements. Company indebtedness, comprising long-term debt including the current portion and bank indebtedness, less cash and time deposits, decreased from $3,000.2 million to $1,978.7 million.

As a result of the debt reduction, an improvement in net income and the reversal of prior years' dividends aggregating $47.6 million (see Note 6b of Notes to Consolidated Financial Statements) the Company's year-end debt ratio decreased from 48.6 per cent to 37.4 per cent.

Planned capital expenditures for 1989 are approximately $550 million. In addition, the Company anticipates that capital expenditures for 1990 and 1991 will aggregate approximately $1.2 billion. The capital expenditure program for 1989 to 1993 includes funds required for renewal of basic plant, purchase of rolling stock and other equipment and improvement of operating efficiency. The Company expects that although the major portion of these expenditures will be funded internally, the aggregate of capital expenditures, together with provision for debt maturities in the period, may require further borrowings.

At December 31, 1988, the Company had commitments to purchase railway ties at an aggregate cost of $26.6 million and rail at a cost of $26.5 million. In addition, the Company was committed to suppliers for new locomotives having a value of $188.9 million which are expected to be obtained under lease arrangements.

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Consolidated Financial Statements December 31, 1988

CN

Consolidated Statement of Income

Year ended December 31 (in thousands)		1988	1987	1986
CN Rail	Revenues	$3,792,115	$3,732,294	$3,669,380
	Expenses	3,571,430	3,618,546	3,681,535
	Income (loss)	220,685	113,748	(12,155)
Grand Trunk Corporation	Revenues	477,816	486,044	531,399
	Expenses	464,882	464,197	545,556
	Income (loss)	12,934	21,847	(14,157)
Enterprises group:				
CN Exploration	Revenues	28,204	37,293	33,869
	Expenses	25,064	26,672	29,368
	Income	3,140	10,621	4,501
CN Real Estate	Revenues	57,188	54,102	35,157
	Expenses	10,376	16,300	16,330
	Income	46,812	37,802	18,827
Other	Income	10,471	7,007	9,006
Total Enterprises group		60,423	55,430	32,334
Total continuing operations		294,042	191,025	6,022
Discontinued operations:				
TerraTransport	Loss	(29,277)	(41,336)	(40,307)
CN Communications	Income	12,362	21,935	34,720
CN Hotels	Loss	(9,137)	(13,113)	(6,324)
Dockyard	Income (loss)	–	1,368	(4,530)
CN Route	Loss	–	–	(25,641)
Total discontinued operations		(26,052)	(31,146)	(42,082)
Premium on early extinguishment of long-term debt		(111,106)	–	–
Income (loss) before income taxes and extraordinary items		156,884	159,879	(36,060)
Income taxes		99,803	76,038	–
Income (loss) before extraordinary items		57,081	83,841	(36,060)
Extraordinary items*		225,584	36,741	(50,220)
Net income (loss)		$ 282,665	$ 120,582	$ (86,280)

** See Note 2*

See accompanying notes to consolidated financial statements.

CN

Consolidated Balance Sheet

December 31 (in thousands)			1988		1987
Assets					
Current	Cash and time deposits		$ 36,286		$ –
	Accounts receivable		416,145		451,322
	Material and supplies		219,152		284,850
	Other		274,136		229,613
			945,719		965,785
Insurance Fund			7,675		10,598
Investments			76,088		170,859
Properties			5,770,440		6,212,562
Other Assets and Deferred Charges			106,113		233,845
			$6,906,035		$7,593,649
Liabilities					
Current	Bank indebtedness		$ 100		$ 63,260
	Accounts payable and accrued charges		806,169		942,250
	Current portion of long-term debt		57,254		208,649
	Other		276,214		237,027
			1,139,737		1,451,186
Provision for Insurance			7,675		10,598
Other Liabilities and Deferred Credits			421,815		298,110
Long-Term Debt			1,957,608		2,728,331
Minority Interest in Subsidiary Companies			4,345		4,345
Shareholder's Equity	Capital stock	$2,278,867		$2,278,867	
	Retained earnings	1,095,988	3,374,855	822,212	3,101,079
			$6,906,035		$7,593,649

See accompanying notes to consolidated financial statements

On behalf of the board

Brian O'N. Gallery, Director

Ronald E. Lawless, Director

Consolidated Statement of Retained Earnings

Year ended December 31 (in thousands)	1988	1987	1986
Balance, beginning of year	$ 822,212	$725,746	$812,026
Prior years' dividends reversed	47,644	–	–
Net income (loss)	282,665	120,582	(86,280)
Dividend	(56,533)	(24,116)	–
Balance, end of year	$1,095,988	$822,212	$725,746

See accompanying notes to consolidated financial statements

CN

Consolidated Statement of Changes in Financial Position

Year ended December 31 (in thousands)	1988	1987	1986
Operating activities:			
Net income (loss)	$282,665	$120,582	$ (86,280)
Non-cash charges to income:			
Depreciation and amortization	293,699	293,045	311,807
Loss (income) of equity investees less dividends	(8,402)	1,473	1,055
Loss (gain) on disposal of business units	(285,113)	(4,900)	18,420
Provision for property impairment	62,683	43,075	4,900
Changes in working capital items*	(40,542)	252,674	(21,194)
Other	66,887	38,484	31,928
	371,877	744,433	260,636
Investing activities:			
Additions to properties	(386,319)	(482,058)	(484,072)
Net proceeds from disposal of properties	71,600	67,590	48,094
Investments in previously consolidated companies	(13,259)	–	–
Other investments	(15,539)	(6,723)	(5,202)
Proceeds from sale of business units	882,283	23,596	23,000
Proceeds from sale of CN Marine Inc. and related assets	–	–	327,558
Redemption of capital stock	–	–	(327,558)
Working capital of previously consolidated companies	(18,642)	(2,747)	(7,633)
	520,124	(400,342)	(425,813)
Cash provided (used) before financing activities	892,001	344,091	(165,177)
Financing activities:			
Issuance of long-term debt	5,772	19,020	435,492
Reduction of long-term debt	(798,327)	(319,477)	(224,490)
	(792,555)	(300,457)	211,002
Net increase in cash	99,446	43,634	45,825
Cash (bank indebtedness), beginning of year	(63,260)	(106,894)	(152,719)
Net cash (bank indebtedness), end of year	$ 36,186	$(63,260)	$(106,894)

** Excluding cash, bank indebtedness, and current portion of long-term debt*

See accompanying notes to consolidated financial statements.

CN

Notes to Consolidated Financial Statements

Note 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Introduction
All references in these Notes to the "Company" refer to Canadian National Railway Company which is wholly-owned by the Government of Canada and, unless the context otherwise requires, its consolidated subsidiaries, and all references to the "System" mean Canadian National Railway Company and its consolidated subsidiaries together with the lines of railway, telecommunications and other property entrusted by the Government of Canada to the Company for management and operation.

a) Principles of Consolidation
The consolidated financial statements include the accounts of all significant subsidiaries and, prior to its disposal in 1988, included the Company's share of the assets, liabilities and income of CNCP Telecommunications which was accounted for by the proportionate consolidation method. Also, consistent with the legislation governing the System, the accounts of the Canadian Government Railways entrusted to the Company by the Government of Canada are included in the consolidated financial statements.

Once a formal plan for the disposition of a significant segment has been adopted, the segment is no longer consolidated but reported under the equity method and included in "Investments" in the consolidated financial statements. The related operating results are reported as results of discontinued operations.

Investments in entities in which the Company has less than a majority interest are accounted for by the equity method, where appropriate.

b) Reporting by Division
In presenting the results by division, interdivisional charges for services have not been eliminated. Consolidated net income is not affected by this practice.

c) Material and Supplies
The inventory is valued at laid down cost based on weighted average cost for ties and rails, latest invoice price for fuel and new materials in stores, and at estimated utility or sales value for usable second hand, obsolete and scrap materials.

d) Insurance Fund
Certain System components are self-insured for various risks, with a separately-invested fund being maintained. The provision for insurance represents the estimated amount of self-insured losses to be settled.

e) Properties
Accounting for railway and telecommunications properties is carried out in accordance with rules issued by the National Transportation Agency of Canada and the Canadian Radio-television and Telecommunications Commission respectively (Canadian properties), and the Interstate Commerce Commission (United States properties). Generally, major additions and replacements are capitalized and interest costs are charged to expense.

The cost of depreciable railway and telecommunications assets retired or disposed of, less salvage, is charged to accumulated depreciation, in accordance with the group plan of depreciation. Other depreciable assets retired or disposed of are accounted for in accordance with the unit plan whereby gains or losses are taken into income as they occur.

The Company follows the successful efforts method of accounting for its oil and gas operations whereby the acquisition costs of oil and gas properties, the costs of successful exploratory wells and the costs of drilling and equipping development wells are capitalized.

f) Depreciation
Depreciation is calculated at rates sufficient to write off properties over their estimated useful lives, generally on a straight-line basis. For railway and telecommunications properties, rates are authorized by the National Transportation Agency of Canada, the Canadian Radio-television and Telecommunications Commission and the Interstate Commerce Commission. The rates for significant classes of assets are as follows:

	Annual Rate
Ties	2.46%-2.71%
Rails	1.93%
Other track material	2.23%-2.83%
Ballast	3.27%
Road locomotives	4.30%
Freight cars	1.73%-3.18%

Acquisition costs of oil and gas properties are amortized on a straight-line basis over the term of the lease until such time as the properties are determined to be productive or judged to be impaired. Acquisition costs of productive properties and costs of successful exploratory drilling and of drilling and equipping development wells are charged against income on the unit-of-production method based upon proven reserves of oil and gas. Exploratory dry hole and acquisition costs judged to be impaired are charged against income in the current period. Other exploratory expenditures are charged against income as incurred.

g) Transportation Revenues
Transportation revenues are generally recognized on completion of movements, with interline movements being treated as complete when the shipment is turned over to the connecting carrier. Costs associated with movements not completed are deferred.

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Note 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

h) Pensions

Pension costs are determined periodically by independent actuaries. Pension expense is charged annually to operations and comprises the total of the following:

- the cost of pension benefits provided in exchange for employees' services rendered during the year, and
- amortization of past service costs over the expected average remaining service life of the employee group covered by the Plans.

The Pension plans are funded through contributions determined in accordance with the accrued benefit actuarial cost method.

i) Foreign Exchange

The Company's foreign operations are classified as integrated and are translated and accounted for on the following bases. Current assets (excluding material and supplies), current liabilities and long-term debt are translated at the rates in effect at the balance sheet date, whereas all other assets and liabilities are translated at historical rates. Revenues and expenses are translated at average rates during the year except for depreciation which is translated at exchange rates prevailing when the related properties were acquired.

The Company's own foreign denominated assets and liabilities are accorded similar treatment. Revenues and expenses are translated at rates prevailing at the time of the transactions except for revenues designated as a hedge against repayment of foreign denominated long-term debt which are translated at the rate in effect at the inception of the debt.

Currency gains and losses are reflected in net income for the year, except for unrealized foreign currency losses on long-term debt. The Company has designated future U.S. dollar revenue streams as a hedge against the repayment of most of its long-term debt denominated in U.S. dollars, and has thus deferred reflecting the related unrealized foreign currency translation losses in net income until the earlier of the debt repayment or the expiry of the hedge. Unrealized foreign currency losses related to long-term debt denominated in U.S. dollars not covered by the hedge are deferred and amortized over the remaining life of the debt. Such deferred amounts are included in the Consolidated Balance Sheet as part of Other Assets and Deferred Charges.

j) Leases

Leases which satisfy the criteria for capital leases and which have been entered into after 1981 have been capitalized. Other leases entered into prior to 1982, satisfying the criteria for capital leases, have been recorded as operating leases.

Note 2: EXTRAORDINARY ITEMS

During 1988 the Company disposed of CN Hotels, the two subsidiary telephone companies and CNCP Telecommunications, with the latter sale including Telecommunications Terminal Systems. In 1987 the Dockyard was disposed of, as was CN Route in 1986.

Asset write-downs to reflect impairments occured affecting CNCP Telecommunications in 1988, TerraTransport in 1987 and Dockyard in 1986.

In 1988, TerraTransport incurred closure costs and in 1986 CN Route was similarly affected.

The financial effect of these transactions together with their effect on the Company's income tax position is as follows:

Year ended December 31 *(in thousands)*	1988	1987	1986
Net gain (loss) on disposal of business units	$285,113	$ 4,900	$(18,420)
Less related income tax effect	(114,958)	(2,381)	–
	170,155	2,519	(18,420)
Loss on write-down of assets	(62,683)	(43,075)	(4,900)
Less related income tax effect	28,051	20,933	–
	(34,632)	(22,142)	(4,900)
Closure cost of discontinued operations	(92,300)	–	(26,900)
Less related income tax effect	41,304	–	–
	(50,996)	–	(26,900)
Reduction in income taxes on application of prior years' losses	141,057	56,364	–
	$225,584	$36,741	$(50,220)

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Note 3: INVESTMENTS

December 31 (in thousands)	Percentage of Voting Interest	1988	1987
Entities accounted for by equity method:			
CNCP Niagara-Detroit Partnership	50%	$20,141	$ 14,757
The Toronto Terminals Railway Company	50%	10,682	10,682
CN Hotels		–	120,025
Other		18,594	13,791
		49,417	159,255
Other companies and investments, at cost less provisions for impairment where applicable		26,671	11,604
Total		$76,088	$170,859

Note 4: PROPERTIES

	December 31, 1988 (in thousands)			*December 31, 1987 (in thousands)*		
	Cost	Accumulated Depreciation	Net	Cost	Accumulated Depreciation	Net
CN Rail	$8,278,744	$3,099,146	$5,179,598	$8,150,866	$2,953,747	$5,197,119
Grand Trunk Corporation	529,510	144,386	385,124	531,609	142,715	388,894
Enterprises group:						
CN Exploration	103,048	45,325	57,723	94,480	35,627	58,853
CN Real Estate	107,784	17,245	90,539	78,881	16,204	62,677
Other	78,849	21,393	57,456	79,152	19,985	59,167
Discontinued operations:						
CN Communications	–	–	–	754,340	308,488	445,852
	$9,097,935	$3,327,495	$5,770,440	$9,689,328	$3,476,766	$6,212,562
Amounts included above with respect to Canadian Government Railways entrusted to the Company by the Government of Canada	$1,026,898	$540,718	$486,180	$1,073,992	$564,974	$509,018

At December 31, 1988 the gross value of assets under capital leases included above was $108.4 million (1987 – $132.5 million) and related accumulated amortization thereon amounted to $12.1 million (1987 – $14.1 million).

CN

Note 5: LONG-TERM DEBT

December 31 (in thousands)	Maturity	Currency in which payable	1988	1987
Bonds, Debentures and Notes				
Canadian National 14⅜% 10 Year Notes	Dec. 1, 1991	United States	$ –	$ 117,817
Canadian National 11⅜% 8 Year Notes	June 11, 1993	Canadian	100,000	100,000
Canadian National 9⅞% 8 Year Notes	Mar. 18, 1994	Canadian	100,000	100,000
Canadian National 12½% 10 Year Notes	Apr. 15, 1995	Canadian	100,000	100,000
Canadian National 6½% 10 Year Japanese Yen Notes (a)	Mar. 26, 1996	Canadian	70,000	70,000
Canadian National 9⅜% 10 Year Notes	Oct. 1, 1996	Canadian	100,000	100,000
Canadian National 9¼% 20 Year Sinking Fund Debentures	Mar. 15, 1998	United States	80,120	89,022
Canadian National 5⅜% 15 Year Swiss Franc Bonds (b)	Aug. 22, 2000	Canadian	98,617	98,617
Canadian National 8⅞% 15 Year Notes	May 21, 2001	Canadian	150,000	150,000
Canadian National 8⅜% 25 Year Sinking Fund Debentures	July 1, 2002	United States	68,858	75,124
Canadian National 9.70% 25 Year Sinking Fund Debentures	July 15, 2004	United States	165,342	174,940
Canadian National 13% 20 Year Sinking Fund Debentures	Nov. 15, 2004	Canadian	93,464	96,732
Canadian National 12¼% 20 Year Sinking Fund Debentures	May 1, 2005	Canadian	125,000	125,000
Canadian National 14% 25 Year Sinking Fund Debentures	Jan. 15, 2006	United States	106,800	178,783
Canadian National 15% 25 Year Sinking Fund Debentures	June 1, 2006	United States	103,244	181,238
Canadian National 16¼% 25 Year Sinking Fund Debentures	Mar. 1, 2007	United States	98,801	183,053
Canadian National 14¼% 30 Year Sinking Fund Debentures	Sept. 1, 2012	United States	83,930	247,984
Canadian National 12% 30 Year Sinking Fund Debentures	Mar. 15, 2013	United States	122,548	122,548
Buffalo and Lake Huron 5½% 1st Mortgage Bonds	Perpetual	Sterling	795	795
Buffalo and Lake Huron 5½% 2nd Mortgage Bonds	Perpetual	Sterling	1,228	1,228
Total Bonds, Debentures and Notes			1,768,747	2,312,881
Government of Canada Loan (c)			173,432	184,765
Other				
Amounts owing under equipment purchase agreements (d)		United States	116,906	137,916
Syndicated loan (e)		Canadian	42,610	42,610
Capital lease obligations (f)		Various	97,052	119,037
Term Loan (g)		United States	2,107	2,634
Adjustment to current exchange rate (see Note 1 i))			12,885	143,861
Total Other			271,560	446,058
			2,213,739	2,943,704
Less: In-substance defeasance (h)			193,753	–
Current portion of long-term debt			57,254	208,649
Unamortized discount and other			5,124	6,724
			256,131	215,373
Long-Term Debt			$1,957,608	$2,728,331

Note 5: LONG-TERM DEBT (cont'd)

a) The Company borrowed $70.0 million at an all-in cost of 10.25% by means of a Euro-yen public note issue and a currency swap.

b) The Company borrowed $98.6 million at an all-inclusive cost of 11.17% by means of a public bond issue in Switzerland and a currency swap.

c) The Government of Canada loan bears interest at 8¾% per annum and is payable in equal semi-annual payments of $13.63 million covering principal and interest to June 30, 1998.

d) Secured by rolling stock and payable by semi-annual or quarterly instalments over various periods to 2000 at interest rates ranging from 8% to 17¾%. As at December 31, 1988, the principal amounts are payable as U.S. $101.0 million (December 31, 1987 – U.S. $121.1 million).

e) The Company borrowed $42.6 million at an all-inclusive cost of 11.535% by means of a yen syndicated loan and currency swap.

f) Interest rates for these leases range from approximately 7⅛% to 14½% with expiry dates occurring during the years 1989 through 2004. The imputed interest on these leases amounts to $92.6 million (1987 – $107.0 million).

g) Repayable by annual principal instalments of $400,000 over a five year term, to August 15, 1992. The interest is charged at favourable varying rates.

h) Certain of the Company's long-term debt is considered to be extinguished as a result of the Company's having placed in irrevocable trusts, government securities sufficient to satisfy the interest and maturing principal requirements of the specific debt obligations involved.

i) Principal repayments, including sinking fund repayments, repurchase arrangements and capital lease repayments, on debt outstanding at December 31, 1988, are as follows:

Year ending December 31	*(in thousands)*
1989	$ 57,254
1990	68,056
1991	72,872
1992	60,772
1993	165,634
1994-1998	743,943
1999-2003	506,837
2004-2008	247,262
2009-2013	87,279

Note 6: SHAREHOLDER'S EQUITY

a) Capital Stock

The capital stock of Canadian National Railway Company, $2,278,866,774, consists of 5,868,786 common shares of no par value authorized, issued and outstanding which are owned by the Government of Canada.

b) Retained Earnings

Under its governing legislation, the Company is required to pay to the Receiver General for Canada a dividend equal to 20% of net income for the year or such greater percentage as the Governor in Council may direct. Accordingly, a dividend representing 20% of the net income for the year, has been accrued and is included in Other Current Liabilities. The dividends accrued on 1985 and 1987 income, which had not yet been paid, have been reversed and transferred to retained earnings on the basis of a Treasury Board of Canada decision dated 15 December 1988.

Note 7: MAJOR COMMITMENTS

a) Leases

(i) The Company's commitments as at December 31, 1988, under leases, excluding those which have been capitalized and for which the lease obligations are recorded as long-term debt (see Note 5), are as follows:

Non-Cancellable Leases *(in thousands)*	Pre-1982 Capital Leases	Operating Leases
Year ending December 31:		
1989	$30,366	$101,807
1990	13,170	74,127
1991	5,682	66,802
1992	4,256	59,575
1993	1,968	56,527
1994-1998	5,431	187,904
1999-2003	2,425	69,296
thereafter	132	4,096
Total minimum lease payments	63,430	$620,134
Less amount representing imputed interest	12,289	
Present value of net minimum lease payments under capital leases	$51,141	

A significant portion of the leases is in respect of railway rolling stock and many of them provide renewal options and an option to purchase the property at fair market value at the end of the lease term.

(ii) Rental expenses under all lease arrangements which have not been capitalized were:

Year ended December 31 *(in thousands)*	1988	1987	1986
Total expenses	$154,719	$173,329	$178,049
Expenses under pre-1982 capital leases included in total expenses	$ 35,248	$ 43,188	$ 46,825

(iii) Increases in income, assets and liabilities in the consolidated financial statements, which would have arisen if leases entered into prior to 1982 and which satisfied the criteria for capital leases had been capitalized, are as follows:

Year ended December 31 *(in thousands)*	1988	1987	1986
Net increase in income	$ 11,552	$ 13,132	$ 11,609
Increase in Assets			
Properties			
Leased properties under capital leases	$169,296	$174,101	$194,092
Less accumulated amortization	138,093	127,481	128,565
	31,203	46,620	65,527
Other assets and deferred charges			
Unamortized deferred exchange loss	3,671	10,172	17,508
	$ 34,874	$ 56,792	$ 83,035
Increase in Current Liabilities			
Present value of obligations under capital leases	$ 25,964	$ 30,900	$ 33,935
Increase in Non-Current Liabilities			
Present value of obligations under capital leases	$ 47,216	$ 73,726	$101,622
Adjustment to current exchange rate (see Note 1 i))	3,925	11,456	22,324
	51,141	85,182	123,946
Less current portion	25,964	30,900	33,935
	$ 25,177	$ 54,282	$ 90,011

b) Other

The Company has commitments at December 31, 1988, for capital expenditures of $26.6 million for railway ties and $26.5 million for rail. In addition, the Company at that date was committed to suppliers for new locomotives having a value of $188.9 million, expected to be obtained under lease arrangements.

Note 8: SUBSIDIES

Revenues include the following subsidies:

Year ended December 31 (in thousands)	1988	1987	1986
Government of Canada			
a) Payments under the Railway Act paid under authority of that Act and the related Appropriation Act in respect of certain uneconomic operations, services and prescribed rates which railways are required by the Railway Act to maintain	$48,854	$37,661	$39,641
b) Maritime Freight Rates Act and Atlantic Region Freight Assistance Act subsidies	19,971	18,520	18,735
c) Sundry	2,510	1,884	2,502
Other assistance	391	134	163
	$71,726	$58,199	$61,041

Note 9: PENSIONS

The Company has retirement benefit plans covering substantially all its employees under which they are entitled to benefits at retirement age generally based on compensation and length of service and/or contributions.

The actuarial valuations as at December 31, 1987, revealed a consolidated actuarial liability of $6.3 billion and a consolidated actuarial asset value of $5.3 billion. It is estimated that, as at December 31, 1988, these amounts could approximate $6.5 billion and $5.9 billion respectively. Subsequent actuarial valuations will determine the actual values at that date.

Annual pension costs were:

Year ended December 31 (in thousands)	1988	1987	1986
	$165,784	$200,731	$194,425

Note 10: SYSTEM INTEREST EXPENSE

Year ended December 31 (in thousands)	1988	1987	1986
Interest			
Total interest on long-term debt	$318,297	$367,142	$380,977
Interest on short-term borrowings	2,431	7,175	6,889
Interest income	(20,269)	(2,435)	(5,567)
	$300,459	$371,882	$382,299

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Note 11: INCOME TAXES

a) The Company has timing differences of approximately $100 million which are available to reduce taxable income of future years.

b) Investment tax credits are also available to reduce future income taxes otherwise payable until the related year of expiry:

Year of Expiry	*(in millions)*
1993	$25.9
1994	$33.9
1995	$29.7
1996	$18.9
1997	$14.0
1998	$ 7.7

c) The Company's provision for income taxes is made up as follows:

Year ended December 31 (in thousands)	1988	1987	1986
Provision for (recovery of) income taxes based on combined basic Canadian federal and provincial tax rate for 1988 of 44.7% (1987 – 48.6%, 1986 – 49.8%)	$70,206	$77,701	$(17,958)
Increase (decrease) in taxes resulting from:			
Non-taxable portion of capital gain on disposals of discontinued operations	–	–	(28,702)
Non-allowable portion of capital loss on early extinguishment of debt	17,670	–	–
Capital losses not allowed for current year	12,726	–	–
Non-allowable foreign exchange loss on conditional sale agreements	686	1,347	1,535
Profit on sale of land	(6,060)	(6,785)	(2,528)
Unapplied losses	–	–	44,318
Other	4,575	3,775	3,335
Actual provision for income taxes resulting in an effective tax rate for 1988 of 63.6% (1987 – 47.6%, 1986 – Nil)	$99,803	$76,038	$ –

Note 12: SEGMENTED INFORMATION

a) Geographic Areas

Virtually all of the System's operations and assets are within Canada with the exception of Grand Trunk Corporation which operates in the United States.

b) International Traffic

In addition to the revenue generated by Grand Trunk Corporation, the System derives revenue from traffic originating or terminating on railroads in the United States. In 1988, such revenues approximated $668 million (1987 – $612 million, 1986 – $587 million).

c) Revenues by Division

December 31 (in thousands)	1988	1987	1986
CN Rail	$3,792,115	$3,732,294	$3,669,380
Grand Trunk Corporation	477,816	486,044	531,399
Enterprises group:			
CN Exploration	28,204	37,293	33,869
CN Real Estate	57,188	54,102	35,157
Other	56,004	40,782	39,821
Discontinued operations:			
TerraTransport	1,459	4,259	8,277
CN Communications	236,884	296,250	298,053
CN Hotels	26,524	135,010	126,131
Dockyard	–	–	8,786
CN Route	–	–	123,643
	$4,676,194	$4,786,034	$4,874,516

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Note 12: SEGMENTED INFORMATION (cont'd)

d) Identifiable Assets by Division

December 31 (in thousands)	1988	1987	1986
CN Rail	$6,006,443	$6,203,938	$6,301,242
Grand Trunk Corporation	611,912	623,715	630,428
Enterprises group:			
CN Exploration	65,239	67,157	68,583
CN Real Estate	141,140	93,603	79,253
Other	81,301	77,685	76,560
Discontinued operations:			
TerraTransport	–	9,874	52,304
CN Communications	–	517,677	497,921
CN Hotels	–	–	136,323
	$6,906,035	$7,593,649	$7,842,614

e) Capital Expenditures and Depreciation by Division

Year ended December 31 (in thousands)	Capital Expenditure*			Depreciation		
	1988	1987	1986	1988	1987	1986
CN Rail	$283,723	$355,146	$356,746	$234,794	$211,045	$212,305
Grand Trunk Corporation	14,370	12,554	21,990	14,157	14,473	18,773
Enterprises group:						
CN Exploration	9,868	9,147	10,859	9,798	10,723	13,093
CN Real Estate	28,560	17,981	13,720	1,102	1,027	815
Other	185	340	364	1,880	1,937	1,884
Discontinued operations:						
TerraTransport	–	589	5	–	2,461	5,964
CN Communications	49,613	68,094	58,129	31,789	45,085	47,061
CN Hotels	–	18,207	22,393	–	6,023	5,278
Dockyard	–	–	(134)	–	–	1,004
CN Route	–	–	–	–	–	5,174
	$386,319	$482,058	$484,072	$293,520	$292,774	$311,351

** Represents additions to properties*

Note 13: OTHER MATTERS

a) The Company carries on ordinary business transactions with various entities controlled by the Government of Canada on the same terms and conditions as current transactions with unrelated parties.

In addition, the Company provides, under contractual arrangements, rail transportation and maintenance services to the Government of Canada and to entities controlled by the latter. The revenue derived from such services rendered in 1988 aggregated $103.3 million (1987 – $148.2 million, 1986 – $203.0 million).

b) Following enactment of the Western Grain Transportation Act, which became effective on January 1, 1984, the Government of Canada, in order to minimize the cost to grain shippers, pays a portion of the cost of shipping grain. Amounts received from the Government of Canada under the Western Grain Transportation Act amounted to $416.0 million in 1988 (1987 – $435.3 million, 1986 – $378.0 million), a reflection of the volume of grain handled.

c) Commencing in 1977, the Government of Canada has agreed to pay to the Company, by way of capital grants not exceeding $557.9 million, certain amounts with respect to expenditures incurred in carrying out rehabilitation programs for branch lines in Western Canada. Total payments received up to December 31, 1988, amounted to $469.3 million of which $12.3 million was received in 1988 (1987 – $25.6 million, 1986 – $34.5 million).

Note 14: RECLASSIFICATION OF COMPARATIVE FIGURES

During 1988, changes were made to improve the classification of certain items and for comparative purposes the 1987 and 1986 figures have been reclassified.

CN

Auditors Report

Touche Ross

1, Place Ville Marie
Montreal (Quebec)
H3B 4T9

Coopers & Lybrand

Le Windsor
1170 Peel Street
Montreal (Quebec) Canada
H3B 4T2

To the Minister of Transport,
Ottawa, Canada

We have examined the consolidated balance sheets of the Canadian National Railway System as at December 31, 1988 and 1987 and the consolidated statements of income, retained earnings and changes in financial position for each of the years in the three-year period ended December 31, 1988. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the System as at December 31, 1988 and 1987 and the results of its operations and the changes in its financial position for each of the years of the three-year period ended December 31, 1988 in accordance with generally accepted accounting principles applied on a consistent basis.

Touche Ross

Chartered accountants
(For the years ended
December 31, 1988, 1987 and 1986)

MONTREAL (Quebec)
February 21, 1989

Coopers & Lybrand

Chartered accountants
(For the year ended
December 31, 1986)

MONTREAL (Quebec)
February 21, 1989

General Review

In 1988, CN's Board of Directors adopted a resolution to merge the Northern Alberta Railways Company Pension Plan with the 1959 Pension Plan effective January 1, 1988. The 1959 Pension Plan, now being referred to as the CN Pension Plan, was also amended during the year to reflect the changes required by the Pension Benefits Standards Act, 1985 and an improvement in the provisions for early retirement. The impact of this improvement increased the Actuarial Liability by $147 million and increased the Company's and the employees' 1988 contributions by about $16 million and $7 million respectively.

Also, pursuant to its response to the Parliamentary Sub-Committee Report on CN's Pension System, the Company met with union and pensioner representatives and agreed to a new composition for the CN Pension Board. The new Board, which was in place for the January 1989 Pension Board meeting, has been increased from 11 to 16 members. The duties of the Board have also been broadened.

Finally, 1988 was the second year of the Company's four-year program of increased pension payments for pensioners. Approximately 35,000 pensioners and survivors benefited from such increases for life, the actuarial value of which amounted to about $39 million.

CANADIAN NATIONAL RAILWAYS PENSION TRUST FUND

Consolidated Statement of Net Assets

Investments

As at December 31 (in thousands)	1988	1987
Bonds – quoted market value		
1988 – $2,165,260 1987 – $2,287,134	$2,084,902	$2,185,495
Mortgages	184,244	207,876
Real estate	339,803	309,869
Oil and gas	135,871	129,546
Equities – quoted market value		
1988 – $2,476,531 1987 – $2,391,138	1,856,183	1,806,059
Short-term investments	969,815	548,380
	5,570,818	5,187,225
Cash	2,313	2,362
Accounts receivable – Canadian National Railways	7,460	6,876
Other net assets (liabilities)	(195,789)	19,734
	$5,384,802	$5,216,197

See accompanying notes to consolidated financial statements.

Auditors' Report

To The Minister of Transport,
Ottawa, Canada

We have examined the Consolidated Statement of Net Assets of the Canadian National Railways Pension Trust Fund as at December 31, 1988 and the Consolidated Statement of Changes in Net Assets for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Canadian National Railways Pension Trust Fund as at December 31, 1988 and the results of its operations for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Also, in our opinion, proper books of account have been kept and the transactions that have come under our notice have been within the powers of the Trustee.

Mallette, Benoit, Boulanger, Rondeau & Associés

Mallette, Benoit, Boulanger, Rondeau & Associés
Chartered Accountants

Montreal, February 20, 1989

CANADIAN NATIONAL RAILWAYS PENSION TRUST FUND

Consolidated Statement of Changes in Net Assets

Year ended, December 31 (in thousands)	1988	1987
Net assets, beginning of year	**$5,216,197**	**$4,662,687**
Net investment income	558,432	746,005
Contributions by employees	87,353	79,402
Contributions by Company	167,265	199,903
Total additions	813,050	1,025,310
Pension benefits paid	410,179	378,806
Refunds	17,140	23,917
Total deductions	427,319	402,723
Net increase before transfers to other funds	385,731	622,587
Transfers to other funds	217,126	69,077
Net increase	168,605	553,510
Net assets, end of year	**$5,384,802**	**$5,216,197**

On behalf of the board

Brian O.N. Gallery, Director

Ronald E. Lawless, Director

Actuary's Report

To the Trustee
Canadian National Railways Pension Trust Fund

We have conducted actuarial valuations as at December 31, 1987 for the 1935 Pension Plan, the 1959 Pension Plan and the Northern Alberta Railways Company Pension Plan, the latter two being merged effective January 1, 1988 and now constituting the CN Pension Plan. These valuations are in accordance with generally accepted actuarial principles and the Recommendations of the Canadian Institute of Actuaries.

At at December 31, 1987, these valuations revealed a consolidated actuarial liability of approximately $6.3 billion, a consolidated unfunded actuarial liability of approximately $1 billion and required consolidated Company contributions, for 1988, of $167.3 million. The next actuarial valuations will be conducted as at December 31, 1990 at the latest.

In my opinion,
- the data on which these valuations were based were sufficient and appropriate for purposes of the valuations;
- the assumptions used were adequate and appropriate for purposes of the valuations; and
- the methods employed in the valuations were consistent with sound actuarial principles.

Bernard Morency

Bernard Morency
Fellow of the Canadian Institute of Actuaries

William M. Mercer Limitée
Montreal, February 10, 1989

Notes to Consolidated Financial Statements

Note 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Principles of Consolidation
The consolidated financial statements include the accounts of the Canadian National Railways Pension Trust Fund and its wholly-owned companies and encompass the 1935 Pension Plan and the CN Pension Plan into which the Northern Alberta Railways Company Pension Plan was merged effective January 1, 1988. These plans under which benefits are generally based on compensation and length of service and/or contributions cover substantially all employees of the Canadian National Railway System.

b) Investment Valuation
(i) Bonds are carried at their amortized cost less deferred amounts arising from exchanges: these amounts are written off over the remaining life of the bonds sold;

(ii) Mortgages are carried at outstanding principal balances and are secured by real estate;

(iii) Real estate consists of land, buildings, and equities. Land is carried at the lower of cost and net realizable value less encumbrances, buildings at the lower of cost and net realizable value less encumbrances and accumulated depreciation calculated using the sinking fund method, and equities amounting to $177.0 million in 1988 (1987 – $147.0 million) at cost. The quoted market value of these real estate equities was $242.7 million as at December 31, 1988 (December 31, 1987 – $167.3 million);

(iv) Oil and gas properties are carried at cost as determined by the full cost method less depletion;

(v) Equities and short-term investments are carried at cost;

(vi) The quoted market value of investments in bonds and equities is based on the closing market quotations as of December 31.

c) Determination of Contributions by the Company
In respect of the 1935 Pension Plan and the CN Pension Plan, the contributions by the Company are determined in accordance with the requirements of the Pension Benefits Standards Act (1985) and regulations thereunder and are based on the accrued benefit actuarial cost method using a projection of salary. Consistent with the regulations and in addition to the current service contribution, the Company is making quarterly special payments to liquidate the unfunded liability by 2006. Also, in the case of the 1935 Pension Plan, the Company makes contributions as determined by the rules of the plan.

In the latest actuarial valuations, the principal assumptions adopted by the Plans' actuary for purposes of the actuarial computations are members' mortality, disability, retirement, termination of employment, merit and periodic increases in earnings, as well as a long-term rate of return of 7.5% per annum on investments. Future increases in members' earnings have been projected using economic assumptions consistent with this long-term rate of return.

d) Accounting for Contributions
Contributions from employees are recorded in the period in which the Company makes payroll deductions. The contributions from the Company as determined by the latest actuarial valuations are recorded using the accrual method.

e) Income Determination
Dividend income is recorded as of the ex-dividend date. Income from other investments is recorded as earned on an accrual basis.

Gain or loss on sales of equities is based on the average cost.

f) Foreign Exchange
Investments denominated in foreign currencies other than short-term investments are translated at historical rates of exchange. Short-term investments and the quoted market value of investments denominated in foreign currencies are translated at current rates. Foreign dividends and interest income are translated at the rates prevailing when received.

g) Transfers to Other Funds
Transfers to other funds are accounted for in the period in which the value of the transfers can be reasonably estimated.

Note 2: TRANSFERS TO OTHER FUNDS

In 1988, the accounts include a provision for the amounts to be remitted to other funds to cover all transfers of CN employees to other parties.

Note 3: RECLASSIFICATION OF COMPARATIVE FIGURES

During 1988, changes were made to improve the classification of certain items and for comparative purposes the 198" figures have been reclassified.

Note 4: LATEST ACTUARIAL VALUATIONS

The latest actuarial valuations for the 1935 Pension Plan and the CN Pension Plan were as at December 31, 198" and were submitted to the Superintendent of Financial Institutions and Revenue Canada. The consolidated actuarial liability and the consolidated actuarial unfunded liability resulting from these valuations amounted to approximately $6.3 billion and $1.0 billion respectively. Also, a market related method was used to value the assets for purposes of the actuarial valuations. This method resulted in a consolidated actuarial asset value which was adjusted to market by recognizing realized and unrealized gains over a period of five years using the straight line method. The consolidated actuarial asset value was approximately $5.3 billion as at the date of the latest actuarial valuations.